

THE SUPREME COURT
FLUNKS TRUSTS

When the administrator of a pension or employee benefit plan denies a participant's claim for a benefit under the plan, and the dissatisfied participant sues to recover the benefit, what standard of review should the court apply in evaluating the reasonableness of the administrator's decision? Should the court adopt a deferential standard of review, presuming the correctness of the administrator's decision and requiring the participant to bear the burden of showing that the decision was unreasonable? Or should the court apply a *de novo* standard of review, considering the merits of the benefit denial without any presumption in favor of the plan's internal decisionmaking?

Because ERISA, the 1974 regulatory scheme,¹ federalizes the field of pension and employee benefit plans, the question of the appropriate standard of review of benefit denials is one of federal law. Because, however, the statutory text fails to speak to the standard of review, the federal courts have had to deal with the question as a matter of decisional law. By the late 1980s, deferential review under the so-called arbitrary-and-capricious standard was the norm among the courts of

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¹Employee Retirement Income Security Act of 1974, P.L. No. 93-406, 88 Stat. 829 (1974), codified as amended primarily in 29 USCS §1001 *et seq* (1982 & Supp 1990). Citation hereafter is to ERISA § numbers rather than to USCS numbers.

appeal,² although some significant exceptions were being carved from that standard, especially in the Third Circuit. In *Firestone Tire & Rubber Co. v. Bruch*,³ the Supreme Court astonished the ERISA bar by overturning the arbitrary-and-capricious standard and instituting de novo review.

The issue in *Bruch* is one of considerable practical importance, on account of the extent of ERISA's turf. Although ERISA is often called the "pension reform law," the statute governs employee benefit plans of all sorts. Among the nonpension plans (called "welfare benefit plans") that ERISA regulates are those that provide most of the nation's health care, as well as plans that provide for severance pay, childcare services, accident and life insurance, tuition and educational assistance, and a variety of other fringe benefits. Health plans alone make millions of benefit determinations every month. Fortunately, most of these decisions flow automatically from unambiguous plan terms, but doubts inevitably arise at the margin. For example: How much vision impairment must a worker suffer in order to qualify as blind under a disability plan?⁴ Or, does a novel medical procedure fall within the definition of covered benefits under a health plan?⁵ Because the number of plans and of benefit determinations is so enormous, benefit denial cases have come to constitute the largest category of ERISA litigation.

There are solid justifications for insisting on more searching review of plan decisionmaking than was occurring in pre-*Bruch* practice. However, the Supreme Court in *Bruch* dealt with the problem so awkwardly that plan drafters have been able to evade the Court's decision. There is reason to think that the very dissatisfaction that brought the issue in *Bruch* to the Supreme Court in the first place will recur, and that the Court will have to face the question anew. Understanding why the *Bruch* decision miscarried is, therefore, a matter of consequence for the future of pension law. Furthermore, because the Supreme Court's opinion in *Bruch* rests on an elementary error in applying long-settled principles of trust law, it is important from the standpoint of trust law to make clear why the Court's position is

²Firestone's Brief in the Supreme Court collects authority from the circuits, at 8, note 5. See also Flint, ERISA: The Arbitrary and Capricious Rule under Siege, 39 Cath. U. L. Rev. 133, 139-43 (1989).

³109 S.Ct. 948 (1989).

⁴*Pokratz v. Jones Dairy Farm*, 771 F.2d 206 (7th Cir. 1985).

⁵*E.g.*, *Egbert v. Connecticut General Life Ins. Co.*, 900 F.2d 1032 (7th Cir. 1990) (in vitro fertilization procedure held covered).

insupportable. The Supreme Court is the final arbiter of federal statutory law under ERISA, but not of the common law of trusts that the Court purported to apply in *Bruch*. Trust law is predominantly a state-law field. The Court can impose a nonsense reading of ERISA by fiat, but it cannot force state courts to repeat the error in ordinary trust law settings.

I. PENSION AND EMPLOYEE BENEFIT TRUSTS

A. WHY PLANS ARE TRUSTS

ERISA requires that pension and employee benefit plans take the trust form.⁶ The idea of mandating that plan assets be trusteeed was not novel to ERISA. The Taft-Hartley Act of 1947 requires that a union-sponsored multiemployer plan take the form of a trust with equal numbers of employer-designated and union-designated trustees.⁷ Since 1921 the Internal Revenue Code has insisted upon the use of the trust for pension plans as a precondition for what we now call "qualifying" the plan for tax benefits.⁸ Back into the last century, at the dawn of the private pension system, employers set up pension plans in the trust form.⁹

1. *Segregation of assets.* There are two main reasons why our legal system has found it convenient to structure plans in the trust form. The trust is a characteristic device for situations in which there is some reason to have a separate entity or conduit. Pension plans have such a need: achieving the deferral of wages. Instead of paying wages directly to the employee, the employer contributes to a segregated fund in which assets accumulate for future payment of benefits. This segregation of the fund is the attribute that made the pension trust attractive for the purposes of the Internal Revenue Code.¹⁰

⁶Unless plan assets take the form of insurance contracts, ERISA §403 requires that "all assets of an employee benefit plan shall be held in trust . . ." ERISA §403(a).

⁷Labor Management Relations (Taft-Hartley) Act §302(c)(5), 29 USC §186(c)(5).

⁸See discussion in Fischel & Langbein, ERISA's Fundamental Contradiction: The Exclusive Benefit Rule, 55 U. Chi. L. Rev. 1105, 1108, and text at note 14.

⁹*E.g.*, *McNevin v. Solvay Process Co.*, 32 App. Div. 610, 53 N.Y. Supp. 98 (1898), *aff'd per curiam* 167 N.Y. 530, 60 N.E. 1115 (1901).

¹⁰Ordinarily, the employer would not receive a deduction for wages paid until the employee receives the payment and is subject to taxes on it. Pension plans are exceptions. The employer gets the deduction currently although the employee receives the benefit in later years. As a general matter (depreciation apart), the Internal Revenue Code is reluctant to allow deductions for mere bookkeeping entries. By requiring that the employer make pension payments into a separate trust, the Code assures that the employer does not get a deduction until the pension

2. *Trust fiduciary law.* The other great advantage of trust law is that it imports a set of well-developed fiduciary standards and ancillary remedial rules. The great rubrics of substantive trust law are the duty of prudent management and the duty of loyalty.¹¹ The trustee is required to invest trust assets and to conduct trust functions in accordance with objectively reasonable standards (prudence). And the trustee is required to deal with trust property for the sole interest of the trust beneficiaries, thus not for the trustee's own gain (loyalty).

The Taft-Hartley Act imposed the trust form on multiemployer plans in 1947 in order to prevent John L. Lewis and other labor leaders from using plan assets for union organizing or for self-enrichment.¹² ERISA was enacted in 1974 in the wake of more than a decade of Congressional investigation into looting and other abuses of plans by some union leaders, and ERISA fiduciary law was meant to be the cure. The drafters of ERISA determined to "apply rules and remedies similar to those under traditional trust law to govern the conduct of fiduciaries."¹³ ERISA insists that persons exercising discretion over plan assets¹⁴ be subject to fiduciary standards that are derived from trust law and that are spelled out in the statute. Let plan drafters be tempted to use the plan documents to squelch the safeguards of ERISA fiduciary law, the statute contains an anti-opt-out measure, section 404(a)(1)(D), requiring that plan documents be "consistent with the provisions of [ERISA]."¹⁵

3. *The exclusive benefit rule.* The centerpiece of ERISA fiduciary law, commonly called the exclusive benefit rule, is ERISA's version of the trust-law duty of loyalty. An ERISA fiduciary "shall discharge his duties with respect to the plan solely in the interest of the beneficiaries and for the exclusive purpose of . . . providing benefits to participants and their beneficiaries."¹⁶

contribution is segregated from the corporate accounts. Segregation into a trust account also has the effect of putting the pension fund beyond the reach of a troubled employer's general creditors.

¹¹Restatement of Trusts (2d) §§170 (loyalty), 174 (prudent administration) (1959); Restatement of Trusts (3d) §227 (prudent investing) (1990).

¹²See Comment, 23 Duquesne L. Rev. 1033 (1985).

¹³Conference Report on HR 2, Pension Reform, HR Rep. No. 93-1280, 93d Cong., 2d Sess. 295, reprinted in 3 Legislative History of the Employee Retirement Income Security Act of 1974, 94th Cong., 2d Sess. 4277, 4562 (1976).

¹⁴On the definition of "fiduciary" in ERISA §3(21), see Langbein & Wolk, Pension and Employee Benefit Law 495-97 (1990).

¹⁵ERISA §404(a)(1)(D).

¹⁶ERISA §404(a)(1)(A)(i).

The drafters of ERISA adapted the exclusive benefit rule from the trust-law duty of loyalty in order to prevent knaves from looting plan funds. The protective purpose that led Congress to impose a federal fiduciary regime to prevent and to remedy abuse of pension plan assets applies equally to nonpension plans. A dollar is a dollar. It does not much matter whether Jimmy Hoffa wants to steal from your pension plan or your health plan. Thus, ERISA fiduciary law applies both to pension plans and to nonpension (welfare benefit) plans, even though ERISA exempts welfare benefit plans from various pension-specific parts of ERISA.¹⁷

B. THE MISMATCH OF PRIVATE TRUST AND ERISA TRUST¹⁸

Alas, there are important differences between the private trust and the pension trust, and ERISA is sometimes insensitive to these differences. That is the problem that underlies the litigation in *Bruch*. The conventional private trust—created, for example, in my will for the support of my widow and children—is a donative transfer. The distinctive logic of a donative transfer is that the benefits are not reciprocal. Unlike a business deal, a gratuitous transfer benefits only the donees. Pension and employee benefit plans, by contrast, arise from contract rather than gratuity. Although the pension and employee benefit system is said to be voluntary, in the sense that regulatory law does not require employers to offer such plans, when an employer does offer a plan, the plan is not a gratuity. Fringe benefits substitute for cash wages. Employers are not donors. Employers offer plans for reasons of economic advantage, in the competition to attract and retain employees. Thus, the employer has continuing economic interests in the plans that it sponsors.¹⁹

The most important of the employer's continuing interests is the employer's liability for plan expenses. A welfare benefit plan pays its

¹⁷In particular, from the vesting and funding rules and the pension plan termination insurance system.

¹⁸This section follows Langbein, *The Conundrum of Fiduciary Investing under ERISA*, in *Proxy Voting of Pension Plan Equity Securities* 128 (Pension Research Council, Wharton School) (McGill ed. 1989); and Fischel & Langbein, note 8 *supra*.

¹⁹Employers incur administrative and regulatory costs in delivering wages in the form of fringe benefits. Employees have various reasons for preferring some fringes over the equivalent in cash wages. Many fringes are tax advantaged, and some (such as group insurance) embody cost reductions that result from economies of scale. A further attraction of pension and employee benefit plans for employers is that such plans facilitate the departure of superannuated employees; they constitute a part of the employer's program of personnel management. For a

expenses on a current basis. In the typical case—for example, my employer's health care plan—my employer is directly responsible for the portion of my health care costs that the plan covers. If I am healthy this year, the savings flow through to the employer. If I am sick, the plan's costs for my health care are expensed to my employer (subject to whatever steps the employer has taken to lay off some of that risk in the insurance markets). Those expenses pass through directly to my employer's income statements as diminutions of net income. As regards pension plans, under the most characteristic type of pension plan, the defined benefit plan, the employer usually bears a similar exposure to plan costs.²⁰

Because the settlor of a private trust does not have a continuing economic interest in the trust fund that he has already given away,²¹ trust fiduciary law quite sensibly imposes a duty of loyalty that directs all the economic benefits of the trust to the trust beneficiaries. By contrast, the defined benefit pension plan or a welfare benefit plan such as a health care or severance pay plan manifests a complex contract in which both employer and employee have important interests. In subjecting these plans to a comparable duty of loyalty—that is, to the exclusive benefit rule—ERISA transposes from the realm of the unilateral donative transfer a regime that in some respects does not fit the characteristics of pension and benefit law. The employer has important economic interests in the operation of its plans, unlike the settlor of a private trust. In truth, ERISA plans are not for the exclusive benefit of the employees; they are for the joint benefit of employer and employees.²² The exclusive benefit rule works well in preventing thugs from looting plans, but in other settings it misdescribes the economic reality of ERISA plans.

more detailed discussion, see *Why Are Pension Plans Employment-Based?* in Langbein & Wolk, note 14 *supra*, at 27–31.

²⁰Under a defined benefit plan, the employer promises to pay a future benefit, commonly expressed in a formula as a fraction of final average salary. Even though the employer has been funding the plan by means of regular contributions, if the fund turns out to be inadequate to pay the accrued benefits, the employer is liable to make up the shortfall. Thus, the employer who sponsors a defined benefit plan bears the plan's investment risk. The healthier the investment returns that the plan experiences, the less that the employer will have to contribute to honor the plan's pension promises.

²¹Restatement of Trnsts (2d) §200 provides: "No one except a beneficiary . . . can maintain a suit against the trustee to enforce the trust . . ." Comment *b* declares that this principle precludes the settlor from enforcing the trust, unless the settlor acts in another capacity under the trust, such as the beneficiary of a retained interest.

²²A main theme of Fischel & Langbein, note 8 *supra*, at 1118–19.

C. THE NONNEUTRAL FIDUCIARY

Perhaps the feature of ERISA architecture that most clearly manifests the tension within ERISA's transposed norms of private trust law is ERISA's authorization of the nonneutral fiduciary. This is the creature who holds center stage in *Bruch*. ERISA section 408(c)(3) authorizes the employer or other plan sponsor to have its own "officer, employee, agent, or other representative" serve as the trustee or in other fiduciary capacities for the plan. Employers routinely exercise this authority, using management personnel to conduct both investment activities (for funded plans) and benefit determinations. ERISA's authorization of nonneutral fiduciaries is difficult to reconcile with ERISA's exclusive benefit rule. As the lower court observed in *Donovan v. Bierwirth*, the most celebrated ERISA fiduciary case, "section 408(c)(3) expressly contemplates fiduciaries with dual loyalties," and this arrangement is "an unorthodox departure from the common law rule against dual loyalties"²³

ERISA's authorization of nonneutral fiduciaries represents an unmistakable concession to the employer's interest in pension and benefit plans. Congress could have adopted the opposite rule, requiring outside persons to serve as plan fiduciaries, but the price would almost certainly have been lower benefit levels and lower levels of plan formation. We have seen that welfare benefit plan expenses come more or less directly off the employer's bottom line, and that the investment experience of defined benefit plans has a comparable bearing on the employer's profit account. Employers view the investment of plan assets and the control of plan expenses as important centers of cost containment, hence as an integral management function. ERISA Section 408(c)(3) necessarily embodies the acceptance of that view, but ERISA neglects to reconcile the resulting conflict between the nonneutral fiduciary and the exclusive benefit rule.²⁴

II. BRUCH IN THE THIRD CIRCUIT

The *Bruch* case arose out of one of those corporate "downsizings" or "deconglomeratizations" that so typified the 1980s.

²³538 F. Supp. 463, 468 (E.D.N.Y. 1981) (citation omitted), aff'd as modified, 680 F.2d 263 (2d Cir. 1982).

²⁴See the discussion in Fischel & Langbein, note 8 *supra*.

Firestone, the tire company, sold off its plastics division, comprising five plants, to Occidental Petroleum. Occidental took over most of the Firestone employees, who, as Firestone employees, had been covered under Firestone's severance pay plan. It provided: "If your service is discontinued, . . . you will be given termination pay [calculated on a length-of-service formula, if you are] released because of a reduction in work force" ²⁵

Some of the employees whose employment with Firestone terminated when they were transferred to Occidental contended that they were within the terms of the plan and entitled to receive severance pay, even though they had employment continuity with Occidental. The plan fiduciaries, who were Firestone managers, denied the claimed benefits "on the ground that the sale of the Plastics Division to Occidental did not constitute a 'reduction in work force' within the meaning of the termination pay plan." ²⁶ The employees sued in respect of the benefit denial. The district court held for Firestone, unremarkably applying the deferential arbitrary-and-capricious standard of review.

The Third Circuit reversed. In a learned and thoughtful opinion, Judge Becker held that *de novo* as opposed to deferential review should pertain. He reasoned that "under ERISA courts must be cognizant of the features that distinguish the ERISA arrangements from the paradigmatic common law situation." ²⁷ Under Firestone's severance pay plan, "every dollar saved by the administrator on behalf of his employer is a dollar in Firestone's pocket." ²⁸ Judge Becker pointed out that trust law has long applied a standard of searching review in situations in which the trustee "is thought to have acted in his own interest and contrary to the interest of the beneficiaries" ²⁹ In this case Firestone "is clearly not disinterested in the amount of severance pay awarded; its impartiality therefore cannot be relied upon to produce a fair result." ³⁰

The Third Circuit's departure from deferential arbitrary-and-capricious review had been anticipated in a few earlier cases, in which

²⁵109 S.Ct. at 951.

²⁶*Ibid.*

²⁷828 F.2d at 143.

²⁸*Id.* at 144.

²⁹*Id.* at 145.

³⁰828 F.2d at 145.

intense conflicts of interest on the part of the plan fiduciaries had led the reviewing courts to scrutinize the benefit denials more carefully.³¹ On the eve of the *Bruch* case, Judge Posner attempted to sum up the authorities by remarking that “the arbitrary-and-capricious standard may be a range, not a point. There may be in effect a sliding scale of judicial review of trustees’ decisions—more penetrating the greater is the suspicion of partiality”³²

In pre-*Bruch* case law some courts had undertaken to justify deferential review on the ground that the court should respect the special expertise of the plan fiduciaries. The arbitrary-and-capricious standard “exists to ensure that administrative responsibility rests with those whose experience is daily and continuous, not with judges whose exposure is episodic and occasional,” Judge Wilkinson wrote in a prominent Fourth Circuit case.³³

Judge Becker in *Bruch* considered and rejected Judge Wilkinson’s view. A benefit denial case does not ordinarily “turn on information or experience which expertise as a claims administrator is likely to produce.” Rather, Judge Becker reasoned, the case “is likely to turn on a question of law or of contract interpretation. Courts have no reason to defer to private parties to obtain answers to these kinds of questions.”³⁴ Judge Becker contrasted fiduciary investment functions; the court should defer to a plan fiduciary’s “decision about how to invest plan funds,” absent evidence of abuse.³⁵

Embodied in this line of reasoning are two rather different arguments, a law/fact distinction and a challenge to the notion that plan administrators possess expertise. Pure construction of the words of an instrument may be likened to the “law” side of the law/fact line, hence for the court, but it is an old truism that issues of law fade into issues of fact. Judge Becker thought that the issue in *Bruch* did not require him to “deal with a determination of fact by a plan administrator,” and he was prepared “to leave for another day the definition of the context, if any, in which courts should defer to such determinations.”³⁶

³¹The case law is reviewed in Fischel & Langbein, note 8 *supra*, at 1133–35.

³²*Van Boxel v. Journal Co. Employees Pension Trust*, 836 F.2d 1048, 1052 (7th Cir. 1987).

³³*Berry v. Ciba-Geigy Corp.*, 761 F.2d 1003, 1006 (4th Cir. 1985).

³⁴828 F.2d at 144.

³⁵*Id.* at n. 9.

³⁶*Ibid.*

The situation in *Bruch* may not have involved the plan in making close determinations of fact, but in most benefit denial settings, construction entails application. The further suggestion that plan administrators do not bring real expertise to their work is problematic. Employee benefits professionals commonly argue, for example, that (especially in small and medium size firms) because they know their workforce, they have a better feel than would a reviewing court for a question such as whether a worker was malingering or hurting.

Actually, Judge Becker did not wholly deny that the administrator may possess expertise. Rather, his main emphasis was on the proposition that the imbedded conflict of interest that inclines a servient administrator to decide in favor of his employer outweighs whatever expertise the administrator may bring to the table. The "significant danger that the plan administrator will not be impartial . . . offsets any remaining benefit which the administrator's expertise might be thought to produce."³⁷

Despite the intuitive appeal of Judge Becker's conflict-sensitive position, there is, at least in some cases, a respectable counterargument. Most plan decisionmaking occurs in the setting of long term or repeat player relations. Employer-dominated fiduciaries have strong incentives not to acquire a reputation for sharp practice in handling benefit claims, a reputation that would harm employee morale and cause employees to devalue plan benefits. Employer-dominated fiduciaries are common in plan administration, even in single-employer plans that have been collectively bargained. This seems to bespeak the sense that—ordinarily—employees do not have much to fear from putting their heads in this particular lion's mouth. Employees (even when unionized) may have recognized that they are better off leaving substantial discretion over benefit denials to the employer, because the employer is more likely to offer plans, and to enrich the benefits, if the employer is left in control of the cost containment decisions at the plan margins.

On the other hand, there are many circumstances in which the employer's incentives for fairness grow attenuated, and the facts in *Bruch* exemplify such a case. The employer's reputational interest is not likely to be effective when the long term relationship between the firm and the workers is dissolving, as in a plant closing or in a corporate restructuring such as Firestone's transfer of the workers in *Bruch*.

³⁷828 F.2d at 144.

III. THE SUPREME COURT OPINION

Justice O'Connor's opinion for the Supreme Court in *Bruch* sustained the Third Circuit's result, but substituted quite a different rationale. Recall that the issue in *Bruch* is whether the reviewing court should presume the correctness of the plan's internal decision-making when an employer-dominated fiduciary renders a decision that benefits the employer.

Judge Becker was self-consciously following trust-law tradition in scrutinizing fiduciary conduct more closely when conflict of interest is suspected.³⁸ The Supreme Court, however, expressly declined to "rest our decision on the concern for impartiality that guided the Court of Appeals," hence refused to pay attention to "whether the administrator or fiduciary is acting under a possible or actual conflict of interest."³⁹ Thus, the Supreme Court decided to require de novo review not on account of the factors that persuaded the Third Circuit to impose de novo review, but even in circumstances in which those factors were absent.

A. DOES TRUST LAW DEFER TO TRUSTEE DECISIONMAKING?

Despite its refusal to follow the Third Circuit in basing the requirement of searching review on the conventional trust-law standard of heightened scrutiny for fiduciary conflicts of interest, the Supreme Court purported to derive its requirement of de novo review from trust law. "In determining the appropriate standard of review for actions under [the ERISA section allowing plan participants to sue in respect of benefit denials], we are guided by principles of trust law."⁴⁰ The Court compacted its discussion of what it deemed to be the relevant trust law into the passage reproduced here:⁴¹

³⁸Judge Becker's opinion, 828 F.2d at 141, reproduces Comment g to Restatement of Trusts §187: "The court will control the trustee in the exercise of a power where he acts from an improper even though not dishonest motive In the determination of the question of whether the trustee in the exercise of power is acting from an improper motive the fact that the trustee has an interest conflicting with that of the beneficiary is to be considered." See also 828 F.2d at 145 ("The principles of trust law instruct that when a trustee is thought to have acted in his own interest and contrary to the interest of the beneficiaries, his decisions are to be scrutinized with the greatest possible care").

³⁹109 S.Ct. at 956.

⁴⁰*Id.* at 954.

⁴¹*Ibid.* The "omitted citations" are references to the standard treatises on trust law, Bogert and Scott.

Trust principles make a deferential standard of review appropriate when a trustee exercises discretionary powers. See Restatement (Second) of Trusts § 187 (1959) (“[w]here discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court except to prevent an abuse by the trustee of his discretion”). [Citation omitted.] A trustee may be given power to construe disputed or doubtful terms, and in such circumstances the trustee’s interpretation will not be disturbed if reasonable. [Citation omitted.] Whether ‘the exercise of a power is permissive or mandatory depends upon the terms of the trust.’ [Citation omitted.] Hence, over a century ago we remarked that “[w]hen trustees are in existence, and capable of acting, a court of equity will not interfere to control them in the exercise of a *discretion vested in them by the instrument under which they act.*” *Nichols v. Eaton*, 91 U.S. 716 (1875) (emphasis added). . . . Firestone can seek no shelter in these principles of trust law, however, for there is no evidence that under Firestone’s termination pay plan the administrator has the power to construe uncertain terms or that eligibility determinations are to be given deference.

It takes very little probing to see why this passage abuses the principles of trust law that it purports to apply. The Court begins by invoking the authority of section 187 of the Restatement of Trusts, which calls for the very deference to trustee decisionmaking that the Court is about to deny in *Bruch*. The trustee’s discretion, the Restatement says, is “not subject to control by the court, except to prevent an abuse by the trustee of his discretion.” This abuse-of-discretion standard is simply the arbitrary-and-capricious standard by another name. And indeed, the Court says in introducing section 187 that “[t]rust principles make a deferential standard of review appropriate when a trustee exercises discretionary powers.”

How, then, did the Court manage both to invoke section 187 and to refuse that deference to fiduciary decisionmaking that section 187 requires? The leap occurs toward the end of the quoted passage. The Court recalls its century-old trust-law precedent, *Nichols v. Eaton*, and underscores a phrase from that opinion—a phrase endorsing judicial deference to trustees’ “exercise of a *discretion vested in them by the instrument under which they act.*” The Court then draws a negative inference from the underscored words. “Firestone can seek no shelter in these principles of trust law, however, for there is no evidence that under Firestone’s termination pay plan the administrator has the power to construe uncertain terms or that eligibility determinations are to be given deference.” Thus, the Supreme Court reasons that, as

a matter of trust law, deference to the trustee's decisionmaking is appropriate only when the trust power in question is particularly granted by the trust instrument.

This distinction between trust powers that derive from the background law of trusts, and those that derive from the trust instrument, is fundamentally mistaken. It is refuted in the very source that the Court treats as authoritative, section 187 of the Restatement of Trusts. Official Comment *a* to section 187 says: "When powers are discretionary. The exercise of a power is discretionary except to the extent to which its exercise is required by the terms of the trust or by the principles of law applicable to the duties of trustees." In other words, discretion does not depend upon an explicit grant in the instrument. The trustee has discretion unless the instrument or some particular doctrine of trust law denies discretion. Discretion is the norm.⁴² What the Supreme Court in *Bruch* calls "the trust law *de novo* standard of review"⁴³ is simply nonexistent in trust law.

B. EXALTING FORTUITY

The Supreme Court's distinction between the law of the instrument and the background law of trusts would frequently lead to bizarre results. For example, legislation such as the Uniform Trustees' Powers Act⁴⁴ or a local equivalent is in force in most American jurisdictions. These acts grant to trustees of private trusts extensive powers to manage and to invest trust assets. Under the reasoning in *Bruch*, if a trust instrument happens to incorporate these powers by terms, the reviewing court should defer to the trustee's decision-making. When, however, the trust instrument is silent on the matter because the drafter has chosen to rely upon the statutebook that authorizes the same powers rather than copy them into the instrument, the rule in *Bruch* would deny judicial deference to the decision-making of the trustees of that trust. Accordingly, the distinction

⁴²So fundamental is this point that the Seventh Circuit has lately reiterated it even while obeying the Supreme Court's commands in *Bruch*: "Under the common law courts will not review the discretionary decisions of trustees and other fiduciaries *de novo*, but will look only for the trustee's abuse of its discretionary authority." *Exbom v. Central States Welfare Fund*, 900 F.2d 1138 (7th Cir. 1990) (Eschbach J., citing Restatement (2d) of Trusts §187).

⁴³109 S.Ct. at 948.

⁴⁴7B Uniform Laws Annotated 741 (1985)

between the background law of trusts and the law of the trust instrument exalts a pure fortuity.

If I had to hazard a guess about why the Court took this distinction, my answer would be that a peculiarity of the facts in *Bruch* made the distinction useful for deciding the particular case, and that not much thought was given to the shortsightedness of letting freak facts resolve the ERISA standard-of-review issue. The peculiarity in *Bruch* is that “[a]t the time of the sale of its Plastics Division, Firestone was not aware that the termination pay plan was governed by ERISA, and therefore had not set up a claims procedure . . . with respect to that plan.”⁴⁵ The plan in litigation in *Bruch* was dramatically exceptional in having no written terms regarding claims matters. By insisting that deference to plan trustees had to rest on the language of the trust instrument, the Court seized on a criterion that the plan in *Bruch* could not satisfy. Other plans, however, can indeed satisfy that criterion, especially after the *Bruch* case alerts plan drafters to the need.

C. INVITING EVASION

The Court in *Bruch* may have thought it was being prudential in resting its decision on a narrow ground, but in conditioning its requirement of de novo review on the language of the plan document, the Court may have found a ground so narrow as to be self-defeating. The Court’s emphasis in *Bruch* on the trust instrument as the basis for deferential review raises the prospect that an ERISA plan may opt out of *Bruch*’s de novo review and back into the pre-*Bruch* world of judicial deference merely by inserting some boilerplate to that effect in the plan instrument. Indeed, in a remarkable passage toward the end of the *Bruch* opinion, the Court seems to invite plan drafters to trump the decision by instrument. *Bruch*’s de novo standard of review pertains, says the Court, “unless the benefit plan gives the administrator or fiduciary discretionary authority to determine eligibility for benefits or to construe the terms of the plan.”⁴⁶

Consider, for example, *Lowry v. Bankers Life & Casualty Retirement Plan*,⁴⁷ first decided in the Fifth Circuit four days before the Supreme Court released its opinion in *Bruch*. The question was

⁴⁵109 S.Ct. at 948.

⁴⁶109 S.Ct. at 956.

⁴⁷865 F.2d 692 (5th Cir 1989).

whether the plan fiduciaries had correctly calculated the employee's compensation base, on which the plan based its retirement benefits. The court emphasized the Fifth Circuit's arbitrary-and-capricious standard and routinely deferred to the plan fiduciaries' calculation. "Discretion is a touchstone of trusteeship, and we invade the province of the trustee only when he violates the proper exercise of his discretion."⁴⁸ The claimant obtained a rehearing in the light of *Bruch* but lost anyhow. "The instruments in this case sharply contrast with the termination pay plan in *Bruch*. [The plan in this case] grants permissive authority to the Plan Committee to 'interpret and construe' the [plan] and the power 'to determine all questions of eligibility and status under the [plan].'" Similar language appeared in a related plan instrument. "Unlike in *Bruch*, there is 'evidence that under' the trust instruments 'the administrator has the power to construe uncertain terms [and] that eligibility determinations are to be given deference.'"⁴⁹

The post-*Bruch* law is now replete with such cases, in which the court decides that a provision in the instrument begets the pre-*Bruch* standard. "In actions challenging the denial of benefits under an ERISA plan which gives the administrator discretion in administering the plan, review is deferential and is limited to determining whether the administrator's action is arbitrary and capricious"⁵⁰

1. *Construing opt-out terms.* The immediate post-*Bruch* case law has been troubled by the question of whether particular language in various pre-*Bruch* plans is adequate to invoke the opt-out deferential review that *Bruch* invites.⁵¹ This is, however, a transitional phenomenon. As drafters amend⁵² pre-*Bruch* plans to make deferential review unambiguous, and as pre-*Bruch* disputes are resolved, this issue will pass out of contention. The players will learn their lines. Boilerplate effective to claim deferential review will be all but universally inserted in plan instruments.

2. *Opt-out policy.* The puzzle about the Supreme Court's handling of the *Bruch* case is now easy to state but impossible to solve. If the

⁴⁸*Id.* at 694.

⁴⁹871 F.2d at 525 (5th Cir. 1989) (quoting *Bruch*).

⁵⁰*McConnell v. Texaco, Inc.*, 727 F. Supp. 751 (D. Mass. 1990). See also, e.g., *Davis v. Kentucky Finance Cos. Retirement Plan*, 887 F.2d 689, 694 (6th Cir. 1989); *Jader v. Principal Mutual Life Ins. Co.*, 723 F. Supp. 1338 (D. Minn. 1989); *O'Dom v. GCIU Supplemental Retirement & Disability Funds*, 722 F. Supp. 365 (S.D. Ohio 1989).

⁵¹*De Nobel v. Vitro Corp.*, 885 F.2d 1180 (4th Cir. 1989).

⁵²ERISA §402(b)(3) requires that plans be amendable.

Court was right to think that the arbitrary-and-capricious standard worsened the situation of plan participants and beneficiaries unacceptably, why did the Court permit plan drafters to reinstitute the arbitrary-and-capricious standard by means of boilerplate grants of discretion? Indeed, quite a plausible argument can be made that ERISA's effort to prevent plan drafters from escaping ERISA's fiduciary norms should prevail in such cases. The statute should be treated as preventing plan drafters from ousting the ordinarily applicable standard of review. Recall that ERISA section 404(a)(1)(D) contains an anti-opt-out clause, requiring plan instruments to be "consistent with the provisions of" ERISA.⁵³ If the purpose of ERISA fiduciary law is to protect plan participants from abusive management by the plan fiduciary, it seems transparently counterproductive to allow the employer to bootstrap around the safeguards of the statute by inserting boilerplate in the plans ordering the courts not to pay much attention to the misbehavior of an employer-dominated fiduciary.

3. *Full circle?* Once plan drafters respond to *Bruch* by modifying plan instruments to insist on deference to plan fiduciaries, the question that Judge Becker confronted in *Bruch* will recur. Should courts defer to plan fiduciaries regardless of the circumstances, or should the courts adjust the scope of deference to take account of factors such as the degree of disinterestedness of the particular fiduciary? Remarkably, the Supreme Court in *Bruch* appears to have anticipated that issue. Toward the end of its opinion, after priding itself on not following the Third Circuit in devising a standard of review that is sensitive to "whether the administrator or fiduciary is operating under a possible or actual conflict of interest," the Court announces: "Of course, if a benefit plan gives discretion to an administrator or fiduciary who is operating under a conflict of interest, that conflict must be weighed as a 'factor[] in determining whether there is an abuse of discretion.'"⁵⁴

Thus, the Supreme Court appears to invite the use of a conflict-sensitive standard of the sort that the Third Circuit tried to devise, once plan drafters have inserted the necessary boilerplate to claim deferential review. The Eleventh Circuit accepted this invitation

⁵³See text at note 15 *supra*. See also ERISA §410(a), declaring "any provision in [an] instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty [to] be void as against public policy."

⁵⁴109 S.Ct. at 956.

with alacrity, holding in *Brown v. Blue Cross & Blue Shield of Alabama* “that when a plan beneficiary demonstrates a substantial conflict of interest on the part of the fiduciary responsible for benefits determinations, the burden shifts to the fiduciary to prove that its interpretation of plan provisions committed to its discretion was not tainted by self-interest.”⁵⁵

To conclude: The Supreme Court made such a tangle of the trust law it purported to apply in *Bruch* that the informed observer will have difficulty understanding what the Court’s purposes really were. Judge Becker trod a perfectly conventional trust-law⁵⁶ path to the Third Circuit’s result in *Bruch*, imposing stricter scrutiny in cases of fiduciary conflict of interest, impliedly preserving deferential review for neutral fiduciaries. The Supreme Court’s decision to impose de novo review in all cases extends the requirement of a searching standard of review to cases in which it hardly seems needed, that is, to cases in which the fiduciaries are genuinely neutral. But if the Court wanted to institute such a dramatically protective standard of review, then the Court’s willingness to allow plan drafters to reinstitute the less searching arbitrary-and-capricious standard by means of a few pen strokes seems inexplicable.

IV. CONTRACT

Since the Supreme Court was determined to institute de novo review (with whatever tolerance for evasion) as the notional standard, the question arises of why the Court did not follow a more conventional doctrinal path to de novo review—contract law. Pension and employee benefit plans originate in the employment contract.⁵⁷ ERISA requires as a matter of regulatory law that plan assets be placed in trust, but ERISA does not delimit the boundaries of trust and contract.

A. DE NOVO REVIEW

De novo review is the norm in contract law for two main reasons. First, contracting parties are expected to be self-interested. The

⁵⁵898 F.2d 1556, 1566 (11th Cir. 1990); accord, *Newell v. Prudential Insurance Co.*, 904 F.2d 644 (11th Cir. 1990).

⁵⁶See text at note 38 *supra*.

⁵⁷See discussion in text at notes 18–19 *supra*.

premise that underlies deferential review in trust law—namely, that fiduciaries are disinterested—is absent in contract.⁵⁸ Second, contracts seldom institute a decisionmaker analogous to a trustee. Thus, in ordinary contract settings, there is neither reason to defer nor anyone to whom to defer.

In the period before ERISA, standard-of-review questions arising from pension and employee benefit plans were understood to be contract questions, and the Supreme Court in *Bruch* refers to that tradition in attempting to justify its reasoning in *Bruch*. The arbitrary-and-capricious standard that Firestone urged in *Bruch* “would require us to impose a standard of review that would afford less protection to employees and their beneficiaries than they enjoyed before ERISA was enacted.”⁵⁹ Elsewhere in its opinion, the Supreme Court draws upon contract notions,⁶⁰ even while asserting that “[i]n determining the standard of review for actions under [ERISA], we are guided by principles of trust law.”⁶¹ Such passages invite the suggestion that the Court may have thought contract while it talked trust.

Indeed, the Supreme Court’s strongest argument for *de novo* review is drawn directly from contract law. It occurs in a paragraph immediately following that awkward passage in which the Court tries to rest its rationale for a trust-law-based *de novo* standard of review on the insupportable distinction between discretion granted under the trust instrument and discretion granted under the background law of trusts. The Court says: “As they do with contractual provisions, courts construe terms in trust agreements without deferring to either party’s interpretation.”⁶² This argument echoes Judge Becker’s suggestion, mentioned above, that benefit denial cases are “likely to turn on a question of law or of contract interpretation.

⁵⁸By contrast, we have seen that, as applied to the pension or employee benefit trust, the premise that fiduciaries are disinterested is faulty. Such a trust is not a true donative transfer. See text at notes 18–22 *supra*.

⁵⁹109 S.Ct. at 956.

⁶⁰“The trust law *de novo* standard of review is consistent with the judicial interpretation of employee benefit plans prior to the enactment of ERISA. Actions challenging an employer’s denial of benefits before enactment of ERISA were governed by principles of contract law. If the plan did not give the employer or administrator discretion or final authority to construe uncertain terms, the court reviewed the employee’s claim as it would have any other contract claim—by looking to the terms of the plan and other manifestations of the parties’ intent.” *Id.* at 954.

⁶¹*Ibid.*

⁶²*Id.* at 955.

Courts have no reason to defer to private parties to obtain answers to these kinds of questions.”⁶³ We have questioned whether Judge Becker’s argument overstates the extent to which benefit denial cases fall on the “law” or “construction” side of the law/fact or construction/administration line, but the distinction is surely sound at the margin. When a benefit denial case entails the construction of an instrument in circumstances in which there is no application to particular facts, there would not be much ground for deferring to the internal decisionmaker either in contract or in trust.

The view that the issue in *Bruch* would be better resolved as a matter of contract law than as trust law is not an academic afterthought. The Solicitor General’s *amicus* brief, which the Court in *Bruch* cites,⁶⁴ urged the Court to view the issue as one of contract. The Solicitor General argued that ERISA’s objectives “are best served by resolving questions of plan interpretation under established principles of contract interpretation.”⁶⁵ The brief observed that “ERISA’s own reliance on trust principles is selective, and in no way suggests that Congress intended that a highly deferential standard be applied here.”⁶⁶ The Supreme Court opinion took over from the Solicitor General’s brief (without attribution) the passage arguing that deferential review under the arbitrary-and-capricious standard leaves employees “worse off than they were before ERISA was enacted.”⁶⁷ However, the Supreme Court opinion suppresses the Solicitor General’s underlying argument—that the comparison to pre-ERISA conditions should incline the Court to a contract-based standard of review.⁶⁸

If there is an advantage to treating the issue in *Bruch* as one of contract law, it is candor. The *de novo* standard of review that the Supreme Court thought appropriate to benefit denial cases follows automatically as a normal incident of contract law. The Court would not have had to distort trust law to obtain *de novo* review. *De novo* review was there for the asking in contract. The puzzle about *Bruch* is

⁶³Text at note 34 *supra*.

⁶⁴109 S.Ct. at 954 (column 2, end).

⁶⁵Brief for the United States as Amicus Curiae Supporting Respondents, at 6.

⁶⁶*Ibid*.

⁶⁷*Id.* at 7. Compare 109 S.Ct. at 956, quoted in text at note 59 *supra*.

⁶⁸Judge Becker also recommended attention to contract law on the remand that the Third Circuit ordered in *Bruch*. “We suggest several principles of contractual construction” for ascertaining what the parties intended in the particular circumstances. 828 F.2d at 147.

not only that the Court insisted on de novo review, but also that the Court insisted on deriving it from trust law (where it is not the rule) rather than contract law (where it is).

B. THE PROTECTIVE POLICY

Was there any reason for the Court to have preferred a distorted version of trust law to a candid version of contract law as the basis for a de novo standard of review? One possibility is that the Court feared that the regime of contract law would allow plan drafters too much latitude for overreaching at the employee's expense. The employer is economically dominant in many employment relationships. Most pension and employee benefit plans are unilateral contracts, offered on a take-it-or-leave-it basis. It's a rare employee who has had the chance to bargain about a pension or health plan, although there is reason to think that employees sort themselves (in choosing among employers and in deciding whether to remain with an employer) in part on the basis of the comparative merits of competing employers' fringe benefits.

In a prominent pre-*Bruch* opinion, *Van Boxel v. Journal Co. Employees Pension Trust*,⁶⁹ Judge Posner voiced the concern that contract standards of review might not adequately vindicate the protective purposes of ERISA. "A Congress committed to the principles of freedom of contract would not have enacted a statute that interferes with pension arrangements voluntarily agreed on by employers and employees. ERISA is paternalistic; and it seems incongruous therefore to deny disappointed pension claimants a meaningful degree of judicial review on the theory that they might be said to have implicitly waived it."⁷⁰

Because, however, the de novo standard of review in contract law is more protective than the deferential standard of trust law as commonly understood before *Bruch*, contract should have been better suited than trust to vindicate this concern to protect employees from overreaching. Actually, the serious problem under either contract or trust is not the implicit waiver to which Judge Posner refers, but explicit waiver, that is, the use of the plan documents to oust the more favorable default rule by imposing deferential review. An employer bent on overreaching may as easily arrange to have the plan docu-

⁶⁹836 F.2d 1048 (7th Cir. 1987).

⁷⁰*Id.* at 1052.

ments oust the default regime of *de novo* review whether that regime is thought to rest on trust or on contract. Since the Supreme Court in *Bruch* invites plan drafters to reinstitute deferential review (albeit subject to the possibility of stricter scrutiny in conflict of interest cases), it seems unlikely that the Court was much concerned with that aspect of the contract standard of review.

If the Court had been worried that a contract-based standard of *de novo* review might be too easy for plan drafters to evade, ERISA offered an easy statutory basis for preventing such maneuvers. Section 404(a)(1)(D)—the measure that requires that plan documents be “consistent with the provisions of” ERISA—could easily have been read to restrict or to prohibit attempts to oust *de novo* review, at least in situations of conflict of interest. Moreover, quite apart from statute, contract law is not defenseless to such moves when protective values are offended. Just as trust law exhibits that tradition of strict scrutiny of a fiduciary’s conflict-tainted transactions upon which Judge Becker relied, so in contract law there are familiar doctrines—unconscionability, *contra proferentum*—for responding to overreaching.⁷¹

Thus, the deep issue that lurks in the standard-of-review dispute when analyzed from the standpoint of contract law is not whether the particular plan actually claims discretion for the employer, but rather whether the protective policy of ERISA should allow such a plan to enforce its claim. ERISA is silent on the precise question. The Supreme Court in *Bruch*, we have seen, waffled on the question, inviting plan drafters to try it, while holding out the possibility that the resulting conflict of interest might be offensive enough to qualify “as a ‘factor[] [to be weighed] in determining whether there is an abuse of discretion.’”⁷²

ERISA abridges freedom of contract in some respects, but not others. For example, ERISA’s vesting rules⁷³ greatly restrict the parties’ freedom to agree upon forfeiture of accrued pension benefits, yet ERISA’s vesting rules do not apply to nonpension benefits such as health care. The courts have repulsed efforts to extend the protective policy of the vesting rules to such benefits.⁷⁴ ERISA contains doc-

⁷¹See, e.g., Farnsworth, *Contracts* §§4.28, at 495–517 (unconscionability), 7.11, at 265–68 (*contra proferentum*) (1990 ed.).

⁷²Text at note 54 *supra*.

⁷³ERISA §203(a).

⁷⁴Most prominently, in *Hansen v. White Farm Equipment Co.*, 788 F.2d 1186 (6th Cir. 1986). See generally Langbein & Wolk, note 14 *supra*, at 421–23.

trinal pegs, such as the anti-opt-out provision⁷⁵ and the exclusive benefit rule⁷⁶ that could be used to defeat contractual provisions enhancing the discretion of employer-dominated administrators. The question is whether and in what circumstances the protective policy of ERISA may be said to justify the use of these doctrines to interfere with plan terms. How protective, in other words, is ERISA meant to be? Likewise, the *contra proferentum* rule, construing the benefit plan contract strictly against the drafter, could be adopted.⁷⁷ But the price of any of these measures will be lowered levels of plan formation and less generous funding. From the standpoint of the protected persons, it seems unlikely that that is the optimal outcome. Here, as elsewhere in the law, it is all too easy to overprotect. That is why Judge Becker's focus on actual conflict of interest as the criterion for strict scrutiny seems to strike such a sensible balance.

V. CONCLUSION

The Supreme Court's opinion in *Bruch* garbles long-settled principles of trust law, confuses trust and contract rubrics, and invites plan drafters to defeat the stated objectives of the decision. *Bruch* is such a crude piece of work that one may well question whether it had the full attention of the Court. I do not believe that either Justice O'Connor or her colleagues who joined this unanimous opinion⁷⁸ would have uttered such doctrinal hash if they had been seriously engaged in the enterprise.

Unfortunately, *Bruch* is not the first instance in which the Supreme Court has discharged ERISA business shoddily.⁷⁹ I understand why a Court wrestling with the grandest issues of public law may feel that its mission is distant from ERISA. The Court may increasingly view itself as having become a supreme constitutional

⁷⁵ERISA §404(a)(1)(D), discussed in text at notes 15, 71 *supra*.

⁷⁶ERISA §404(a)(1)(A), discussed in text at notes 16–17 *supra*; of comparable import is the anti-inurement rule of ERISA §403(c)(1).

⁷⁷A Ninth Circuit panel has started down this path, holding in a recent case against an ERISA-covered health insurer "that the rule of *contra proferentum* applies [either] . . . as a matter of uniform federal law or because federal law incorporates state law on this point." *Kunin v. Benefit Trust Life Ins. Co.*, 910 F.2d 534, 540 (9th Cir. 1990).

⁷⁸Justice Scalia expressed a reservation about the Court's reasoning in an unrelated question decided in the same case, see 109 S.Ct. at 958–59.

⁷⁹*E.g.*, *Connolly v. PBGC*, 106 S.Ct. 1018 (1986); *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724 (1985); *PBGC v. Gray*, 467 U.S. 717 (1984); *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979).

court, resembling the specialized constitutional courts on the Continent. If so, the time may have come to recognize a corollary. If the Court is bored with the detail of supervising complex bodies of statutory law, thought should be given to having that job done by a court that would take it seriously.

The solution long familiar on the Continent is to have separate courts of last resort superintend such fields. A supreme court specializing in ERISA matters, and probably in Social Security and tax law as well, would treat these subjects with respect, which is more than can be said for the U.S. Supreme Court in *Bruch*. Within legal policy circles in the United States, the caseload problem of the federal courts has given rise to renewed interest in specialized courts.⁸⁰ ERISA is an ideal field for experimenting with specialized courts: It is complex, it is important, and it is relatively well delimited from other fields. The evidence from *Bruch* is that this is a sphere of subject matter jurisdiction that the Supreme Court would scarcely miss.

⁸⁰See the symposium on specialized adjudication in 1990 *BYU L. Rev.* 377–575.

